



# Economic and Social Survey of Asia and the Pacific 2007

*Surging Ahead in Uncertain Times*



ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

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# FOREWORD

Asian and Pacific nations are rapidly emerging as engines of global growth. In 2006, the 7.9 per cent increase in the size of the region's developing economies represented a third of worldwide growth. Significantly, these gains were broadly distributed among all subregions. The area's developed economies expanded by a healthy 2.2 per cent, while even countries affected by the 1997 Asian financial crisis reported robust 5 per cent growth and a reassuring macroeconomic outlook, with inflation under control, improved external accounts and stronger financial systems.

These encouraging trends are set out in the *Economic and Social Survey of Asia and the Pacific 2007*. However, the *Survey* cautions against complacency. Deeper integration into the global economy offers exciting opportunities for Asian and Pacific nations, but it also poses its own unique challenges. This year's *Survey* identifies some of these concerns, and analyses the near- and medium-term policy implications.

The *Survey* also addresses the issue of gender discrimination. Restrictions on women's choices and opportunities carry significant socio-economic costs at all levels of society. The *Survey* proposes action in four basic sectors: economic participation; education; health; and empowerment. In each area, examples of best practices illustrate the proven efficacy of the recommendations.

This publication is a timely and valuable contribution towards a better understanding of the many development challenges faced by the nations of Asia and the Pacific. I hope it will prove particularly useful to policymakers as they work to grow their economies and achieve the Millennium Development Goals.



Ban Ki-moon  
Secretary-General

March 2007

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# EXECUTIVE SUMMARY

## Impressive growth in 2006 amid rising risks

Developing economies in the Asia-Pacific region grew at 7.9% in 2006, up from 7.6% in 2005. The continuing buoyancy of external demand remained a source of growth for many countries. Exports of electronics continued to be a key source of growth, while oil and gas exports remained strong in the Islamic Republic of Iran and the oil and gas exporters of North and Central Asia, and South-East Asia. Domestic demand drove gross domestic product (GDP) growth in South and South-West Asia, particularly on the back of high investments.

The region's impressive economic performance was against the backdrop of a riskier global environment. Oil prices hit a record high in the middle of 2006, while stock markets plummeted across the Asia-Pacific region, raising fears of a downturn. Global imbalances steadily widened, with the current account balance of the United States of America deteriorating by a further \$100 billion in 2006, increasing the possibility of an abrupt depreciation of the United States dollar. The sharp appreciation of major currencies in the region against the United States dollar made it difficult to keep exchange rates competitive while addressing inflationary pressure. The suspension of the Doha Development Round in July 2006 did not bode well for a region driven by trade and ready to gain from further liberalization.

Despite high and volatile oil prices in 2006, developing economies in the Asia-Pacific region kept inflation under control at 4.3%, similar to that of the previous year. Asian currencies were strong, reflecting larger-than-expected current account surpluses and capital flows, including those for speculative purposes. Developing countries in the region continued to add to their sizeable foreign exchange reserves, which had reached an unprecedented \$2.5 trillion at the end of 2006. The large increase in reserves points to continuing efforts to push down the region's currencies by official intervention. Current account balances deteriorated across the region in 2006, mainly a result of rising oil imports. Strong exports in many countries offset some of the effects of rising oil prices. The region's exports grew at an impressive 18%, benefiting from healthy global demand.

## Subregional performance – led by East and North-East Asia

Economic growth has been widely shared, with all subregions performing robustly. In keeping with the region's rapid integration into the global economy and the sectors in which it is most competitive internationally, the process of expansion has been concentrated in the industrial and services sectors.

East and North-East Asia had stronger than expected growth of 8.5%. Investment continues to accelerate in China, while investment and consumption posted healthy gains in Hong Kong, China and Macao, China. Except in China, some significant impediments still constrain domestic demand, leaving the subregion dependent on global growth to sustain its expansion. The challenges and opportunities emerging for Asia-Pacific economies from China's reshaping of global and regional trade patterns is examined in a policy research feature.

Averaging around 7.5%, economic growth was also strong in North and Central Asia in 2006, its seventh consecutive year of rapid growth. High oil prices continued to fuel inflation and the rapid growth of net oil exporters, such as Azerbaijan, Kazakhstan and the Russian Federation. The oil boom raises concerns about "Dutch disease", however, and this is examined in a policy research feature.

With few exceptions, Pacific island countries showed positive economic growth, ranging from slightly less than 2% in Tonga to more than 6% in Vanuatu. Growth was led by the primary sector in Papua New Guinea and the services sectors in the smaller countries. Pacific island developing countries are urbanizing at an alarmingly rapid pace, and the challenges associated with their urbanization are examined in a policy research feature.

Strong economic growth continued in South and South-West Asia, with industry and services the major contributors. India led the growth momentum by expanding 9.2%. Exports increased in all countries in the subregion, but imports grew even faster, partly due to higher oil prices. The Islamic Republic of Iran, the only net

exporter of oil in the subregion, grew by 6.1%, the result of higher oil prices. The lack of physical infrastructure is constraining growth in the subregion, so investment in physical infrastructure is a priority, which is examined as a policy research feature.

Driven by strong external demand, economic growth in South-East Asia stood at a robust 5.9% in 2006. Strong external demand, especially for electronics, was the principal driver of growth. As a result, the current accounts of major economies in the subregion are estimated to have remained in surplus. Recognizing the importance of having well-functioning bond markets, a policy research feature focuses on corporate bonds, and re-examines the role of public policy.

All three developed countries in the region enjoyed modest growth. Capacity constraints tightened in Australia and New Zealand, creating inflationary pressure. Japan still looked for firm signs of graduating from deflation with limited growth in wages despite signs of labour shortages. The issue of poverty and inequality in Japan which came to prominence during the recession is highlighted in a policy research feature.

## Outlook for 2007 – continuing dynamism

For developing economies in the Asia-Pacific region, economic growth is projected at 7.4% in 2007, slower than in 2006. The external environment is expected to be less favourable, mainly due to the slowing United States economy. A moderate decline in global electronics demand in 2007 may dampen the Asia-Pacific region's prospects. And the easing of commodity prices, including that of oil, comes as a mixed blessing.

As the international economic environment weakens, momentum in the region is expected to come from China, India and Japan. Together, these three economies contribute over 60% of the GDP of the Asia-Pacific region and close to 45% of imports, thereby creating considerable opportunities for the region.

Inflation will be less of a problem in 2007. For developing Asia-Pacific economies, it is projected at 3.8% for 2007, down from 2006. The fall in oil prices is expected to lessen inflationary pressures, while tight monetary policies across the region are also expected to help. Exchange rates, expected to appreciate further in 2007, would be an added brake on inflationary pressure. The current account surplus for emerging Asian economies is expected to fall slightly in 2007, though it will remain high. Further appreciation of exchange rates and reduced global demand in electronics and information technology components together with a rebound in domestic demand would contribute to the decline in current account surpluses.

Currency appreciation is expected to continue in 2007. It will be increasingly difficult for monetary authorities to pursue an independent monetary policy in response to shocks, as was the case in 2006, while targeting exchange rates against the backdrop of more open capital accounts. Monetary authorities can choose any two of three policy options: monetary autonomy, exchange rate targeting and capital convertibility – but not all three.

Greater exchange rate flexibility is one sustainable solution. It should take away the “one-way bet” that encourages even more capital inflows than otherwise because markets would quickly realize that the currency could move in either direction. In those economies where the central bank has not made a commitment to price stability, they could continue to manage their nominal exchange rates, but they would have to forego the practice of sterilized

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